GAO
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General Accounting Office
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General Government Division

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December 15, 1994

The Honorable Dennis DeConcini, Chairman
The Honorable Christopher S. Bond
Ranking Minority Member
Subcommittee on Treasury, Postal Service
and General Government
Committee on Appropriations
United States Senate

The Honorable Steny H. Hoyer, Chairman
The Honorable Jim Ross Lightfoot
Ranking Minority Member
Subcommittee on Treasury, Postal Service
and General Government
Committee on Appropriations
House of Representatives

This letter responds to a directive in House Conference Report 103-741 dated September 22, 1994, that we review the fee structure and methodology used by the Internal Revenue Service (IRS) in developing user fees to ensure that the proposed fees reflect no more than actual costs.

At the time of the conference report, IRS had already increased an existing fee and proposed three new ones.

-- IRS increased the fee for copying tax records from $4.25 to $14.00 per tax return. IRS said the increase reflected increased costs since the last fee adjustment in the mid-1980s. The fee increase had already been promulgated by the time of the fiscal year 1995 appropriations act. Thus, we did not include it in our review.

-- One proposed user fee, for direct deposit indicators associated with the electronic filing program, has since been dropped. The Department of the Treasury announced in October 1994 that it would no longer provide the direct deposit indicator service.

-- IRS is proposing two types of installment agreement fees: one for new installment agreements and a second fee for restructured agreements. IRS proposes fees of $43 and $24, respectively, for these services.

It is our understanding, based on consultations with committee staff, that the conference's primary interest for our study was the proposed direct deposit indicator fee. Because IRS decided to stop providing the direct deposit indicator service, that fee is no longer an issue. Thus, we limited the scope of our work to the proposed fees for installment agreements. And, given the January 1995 reporting date imposed by the conference report, we did not do an indepth evaluation of IRS' methodology to derive these proposed fees. Rather, we limited the depth of our work to obtaining IRS' summary cost data used to support the proposed fees and discussing this data and IRS' methodology with IRS officials.

USER FEE GUIDANCE

The applicable guidance regarding user fees is contained in 31 U.S.C. 9701 and the Office of Management and Budget's Circular No. A-25, entitled "User Charges". Circular A-25 states that user charges should recover the full cost of providing services to identifiable recipients beyond those that accrue to the general public. In determining the full cost, agencies are to include all direct and indirect costs such as personnel costs (including salaries and fringe benefits, i.e, medical insurance and retirement), physical overhead, and management and supervisory costs. Circular A-25 also provides that the full cost can be determined or estimated from the best available records and that new cost accounting systems need not be established solely for this purpose. However, the legislative guidance states that user fees must be fair and the basis for setting such fees need not be determined solely on the cost to the government. Thus, agencies may charge fees below what they determine to be the full cost.

METHODOLOGY USED BY IRS

IRS does not presently have a cost accounting system and IRS officials told us that the proposed user fees were based on their best estimates of full costs as required by Circular A-25. The estimates were generated largely from data produced at two IRS offices that are serving as prototypes for developing IRS' activity-based costing system: fiscal year 1992 costs at the Cincinnati Service Center and fiscal year 1993 costs at the Seattle District Office. IRS officials told us that these locations had recently completed studies on installment agreement costs and they felt that this data could be used in estimating nationwide costs.

IRS officials told us that many cost components were used in establishing the proposed fees and that the key variables included estimates of (1) the number of installment agreements; (2) direct and some indirect costs incurred by field offices;

(3) software maintenance costs; (4) administrative costs; and (5) costs related to internal training and taxpayer education.

The results of IRS' methodology suggested that the cost of a new installment agreement would be $43.86 and the cost for restructured agreements would be $24.49. The proposed fee for new agreements was derived from a weighted average of lower cost agreements initiated at IRS' Cincinnati Service Center ($11.34 per agreement in 1992) and higher cost agreements at IRS' Seattle District Office ($73.29 per agreement in 1993); IRS also added estimates for additional items not included in these costs. The proposed fee for restructured agreements was based on calculations of the labor hours and other costs associated with processing changes to prior agreements. IRS subsequently decided to round down its proposed fees to $43 and $24, respectively.

In developing its proposed fees, IRS officials said that all indirect costs were not included because of complexities in determining how to allocate these costs to installment agreements. Indirect costs related to capital investment, national office overhead, information systems, keypunching, taxpayer service inquiries, employee leave, and inflation adjustments for fiscal years 1993-95, were not included in IRS' calculations. IRS officials said that their inability to include all indirect costs indicates that their proposed user fees do not exceed actual costs.

GAO OBSERVATIONS

IRS has proposed flat fees for installment agreements. Such fees would fall heaviest proportionately on taxpayers with smaller balances or those who pay their agreements off quickly. Also, because IRS requires financial information from taxpayers with agreements of more than $10,000, it could be argued that IRS incurs higher costs for establishing such agreements and that those taxpayers should pay a higher fee. A flat fee also does not recognize that IRS' costs increase each time IRS sends monthly billing notices to taxpayers. While a single flat fee for new agreements is easier and less costly to administer, separate fees which would differentiate between agreements which are longer and require more information and review than those that do not may be more equitable.

Given the limited cost data available to IRS, we could not validate that the proposed fees reflect no more than actual costs. IRS is developing an activity-based costing system--the Cost Management Information System--which should give it the capability to develop more comprehensive cost information for all activities including installment agreements. We believe that the

lack of specific cost data available to IRS in developing the proposed installment agreement user fees underscores the need for the timely completion of its cost system.

AGENCY COMMENTS

On December 14, 1994, we met with IRS officials, including the Chief Financial Officer, who provided technical comments on a draft of this letter, which we incorporated as appropriate. These officials also pointed out that decisions on how best to structure these fees are within the area of legitimate agency discretion.

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Copies of this letter are being sent to IRS and other interested parties. If you have any questions, please call me at 512-5407.

Jennie S. Stathis

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